Our Soviet Health System

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When my Labrador retriever became acutely lame, we were able to locate a veterinary orthopedic expert in Atlanta within 48 hours who was able to repair a ruptured tendon within one week. But my prospects of identifying an endocrinologist who can care for my daughter's diabetes when she turns 18 are much less promising.

The limited number of endocrine specialists is a not a consequence of limited demand -- everyone is aware of the epidemic of diabetes we are facing. There are also shortages of generalists and other specialists, and the reason is the absence of market signals -- i.e., market-based prices -- for influencing the supply of physicians in various specialties.

The roots of this problem lay in the use of administrative pricing structures in medicine. The way prices are set in health care already distorts the appropriate allocation of efforts and resources in health care today. Unfortunately, many of the suggested reforms of our health care system -- including the various plans for universal care, or universal insurance, or a single-payer system, that various policy makers and Democratic presidential candidates espouse -- rest on the same unsound foundations, and will produce more of the same.

The essential problem is this. The pricing of medical care in this country is either directly or indirectly dictated by Medicare; and Medicare uses an administrative formula which calculates "appropriate" prices based upon imperfect estimates and fudge factors. Rather than independently calculate prices, private insurers in this country almost universally use Medicare prices as a framework to negotiate payments, generally setting payments for services as a percentage of the Medicare fee structure.

Many if not most administratively determined prices fail to take into consideration supply and demand. Unlike prices set on the market, errors are not self-correcting. That is why, despite an expanding cohort of patients with diabetes, thyroid disease and other endocrine disorders, the number of people entering this field is actually dropping. Young physicians are accurately reading inappropriate price signals.

In their book, "The Turning Point," Soviet economists Nikolai Shmelev and Vladimir Popov focused on key factors which undermined the economy during the communist era. They concluded that Goskomtsen, the agency responsible for setting prices, was simply incapable of setting and tracking prices on the myriad of goods and services under its purview.

The failures they describe sound disturbingly similar to challenges to Medicare described by Paul Ginsburg in "When the Price Isn't Right: How inadvertent payment incentives drive medical care" (Health Affairs, August 2005). Assessments as to the accuracy of

pricing is always difficult, time consuming, costly, and more often than not, methodologically flawed. No matter which formulas and variables are used at any given moment, the information derived will generally be inaccurate; it will either be wrong to start or will be applied in the wrong context, or become dated so rapidly it is of little use.

Many prices will be too high or too low, and political forces tend to keep inappropriate prices in place -- specialists in fields with excessive payments will resist cuts, and there will not be enough specialists in low-paid fields to become an effective counterlobby. New physicians will react to existing prices, and so the misallocation of human resources will be self-perpetuating.

Nevertheless, those who control public policy, and public policy debates, treat pricing as something trivial -- the concern of bourgeois shop keepers peddling trinkets. Yet the dilemma of administrative pricing causes problems for the allocation of resources today that would only be amplified if the U.S. moves toward even more government intervention in health care than already exists. Where do prices come from, how do we know when they are right? If the prices set are mistaken -- result in a mismatch of supply and demand -- how are they to be corrected if pricing decisions are made in a political (bureaucratic) arena, and by the market (supply and demand)? These questions cannot be wished away.

One important lesson of the 20th century is that, while markets are far from perfect, more choices are available when people are able to use free markets to interact with each other. Markets may not get the prices exactly correct all the time, but they are capable of self-correction, a capacity that has yet to be demonstrated by administrative pricing.

It tells you something when the supply of and demand for specialist veterinary care is so easily matched when the prices of these services are established on the market -- while shortages and oversupplies are common for human medical care when the prices of these services are set by administrators in the public sector. Will health-care reformers -- and American citizens -- get the message?

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